Flowing *energy*

ONSTREAM...
DELIVERING
VALUE

2001 ANNUAL REPORT

CORPORATE
PROFILE

Flowing Energy Corporation is a junior resource company driven to deliver value to its shareholders. Its principal business is the exploration, development and production of natural gas and crude oil in Alberta. Flowing targets low-risk opportunities offering significant upside potential.

Flowing Energy's common shares trade on the TSX Venture Exchange under the symbol FLO.

Flowing
ENERGY

Notice of Annual Meeting of Shareholders

The Annual General Meeting of Shareholders of Flowing Energy Corporation will be held on Thursday, June 19, 2002 at 2:00 pm in the Cardium Room of the Calgary Petroleum Club at 319 Fifth Avenue SW, Calgary, Alberta.

HIGHLIGHTS

	Year Ended December 31, 2001	Year Ended December 31, 2000
OPERATING		
Production		
Crude Oil & NGLs (bbls/d)	7	24
Natural Gas (mcf/d)	356	210
Barrels of Oil Equivalent (boe/d)	66	59
Average Selling Price ($/boe)	26.14	29.54
Field Net Backs ($/boe)	17.09	21.12
Operating Costs ($/boe)	9.05	8.42
Reserves		
Proven		
Crude Oil & NGLs (mbbls)	15	27
Natural Gas (mmcf)	915	934
Barrels of Oil Equivalent (mboe)	168	183
Proven and Probable		
Crude Oil & NGLs (mbbls)	25	40
Natural Gas (mmcf)	1,307	1,898
Barrels of Oil Equivalent (mboe)	242	356
Wells Drilled/Recompleted		
Gross	2	5
Net	1.25	3.75
Undeveloped Land (Gross)	9,505	10,145
FINANCIAL ($ thousands except per share amounts)		
Crude Oil & Natural Gas Revenue	631	634
Cash Flow from Operations	175	164
Per share	0.02	0.02
Net Earnings	(76)	(128)
Per share	(0.01)	(0.02)
Capital Expenditures (net)	518	2,379
Total Assets	2,278	2,760
Working Capital Position	(15)	(546)
Shareholders' Equity	865	692
SHARE DATA (mumber/thousands)		
Weighted Average Outstanding	7,597	7,053
Outstanding at end of period	9,507	8,357
Fully Diluted at end of period	12,080	11,094
Trading Price ($ per share)		
High	0.70	0.79
Low	0.12	0.15
Close	0.15	0.50
Shares Traded (thousands)	930	947

CHAIRMAN'S MESSAGE

In 2001 we refocused our strategy for delivering value to our shareholders.

Following our exploration program in 2000, our efforts during the first half of the year centred on farming out some of our existing prospects. We executed a seismic option agreement with an industry partner for our 5 1/4-section exploration block in the Chigwell area, with any undrilled spacing units returning to Flowing in 2003. In addition, we successfully farmed out our Ferrybank prospect to test a Belly River light oil play.

We also saw our previous farmouts come to fruition during 2001. Our Gilby prospect, which was farmed out to an intermediate production company, was drilled in March and resulted in a successful oil well. Two farmout wells in the Chigwell area both resulted in successful gas wells.

Recognizing the value of our existing assets and ability to grow internally, we refocused our efforts during the latter part of the year towards generating prospects with low geological risk and acquiring assets with significant exploitation upside. Key personnel were added to the Company to both develop these low-risk exploration and exploitation plays and execute these ideas effectively.

Towards the end of the year, Bob Bowman joined us and was later appointed President, Chief Operating Officer and Director. With over 21 years' experience primarily as the operations manager of intermediate energy companies, Mr. Bowman's proven ability to achieve drilling and operating efficiencies will be invaluable to the Company. Furthermore, his extensive contact network offers Flowing preferential access to property divestitures that meet our exploration and exploitation criteria.

On a corporate level, Flowing raised just over $400,000 through a flow-through equity placement and eliminated $500,000 of short-term debt in 2001. We were also successful in resolving our dispute with the parties associated with our Major Transaction early in the year.

For 2002, our objectives are fourfold:

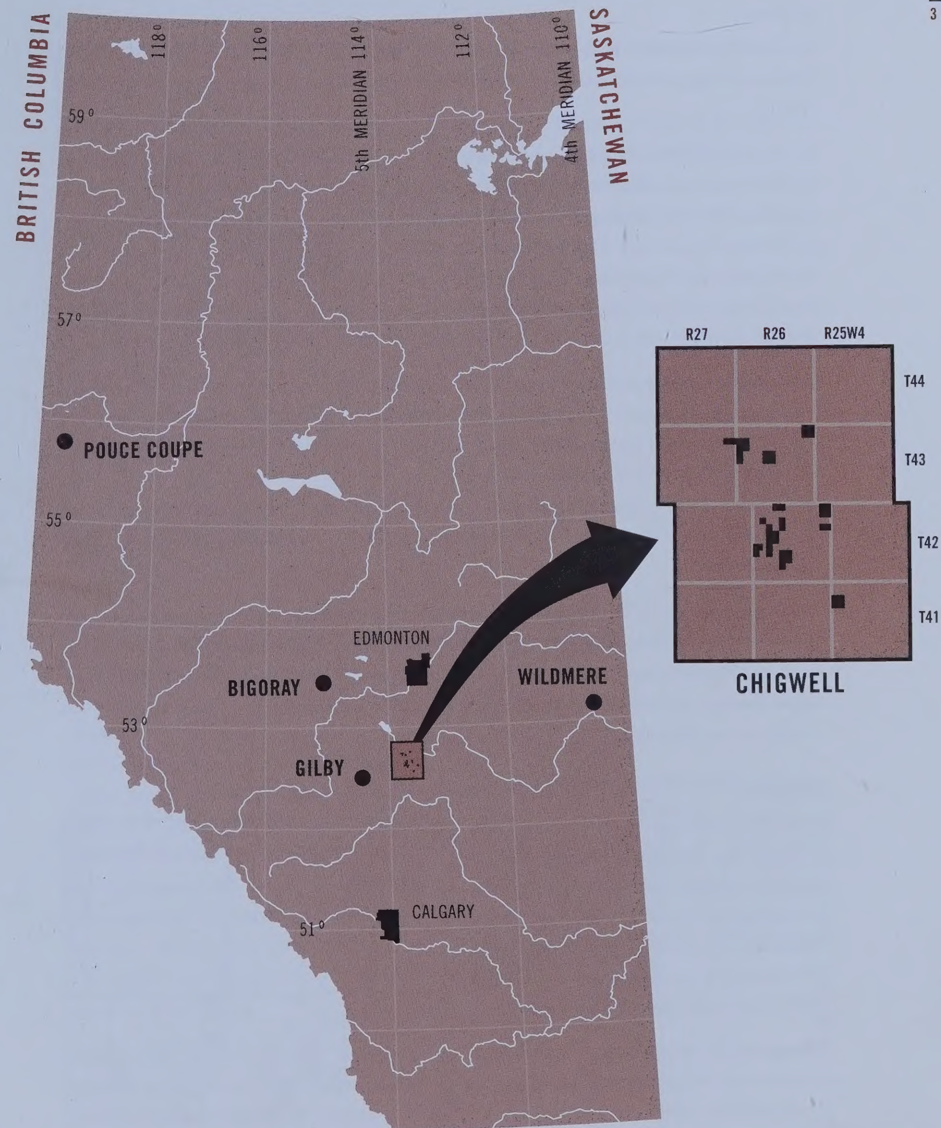
- Year end production rate of 250 boepd
- Year end operating cash flow of $75,000 per month
- Maintain finding and development costs under $8 per boe
- Maintain operating costs under $10 per boe

Our refocused strategy has resulted in some early success. At the end of the year we drilled, completed and tied-in our 102/6-36-42-26-W4M Belly River gas well. Our new play idea at Wildmere drilled in the first quarter of 2002 resulted in a successful oil well that could ultimately hold significant upside potential for the Company.

To implement our strategy in 2002, we are currently raising approximately $1.8 million through a combination of debt and equity. I remain excited about our prospects for this year and look forward to reporting the successful achievement of our objectives next year.

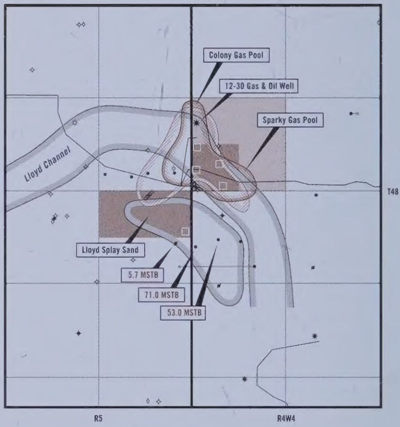
Michael R. Binnion
Chairman

OPERATIONS AND EXPLORATION OVERVIEW



PRODUCING PROPERTIES

Wildmere



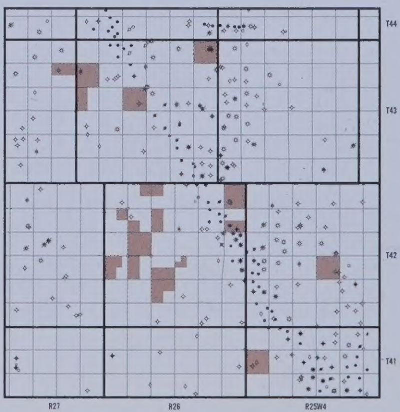
Located 25 km southeast of Vermillion, Alberta, Wildmere is being developed as a new core area for Flowing.

In March 2002, Flowing drilled its first test well on this prospect. The 10-24-48-5-W4M was drilled 100% by Flowing to a total depth of 709 metres in the Lower Mannville and was cased as a potential Lloyd sand oil well. The well was completed and placed on production in early April at a rate of 15 bopd.

Flowing holds a 100% working interest in the well subject to a convertible sliding scale 5% – 15% GORR until payout. After payout, Flowing will retain a 70% interest in the well spacing unit. Flowing also maintains a 70% working interest in the balance of the lands in the north half of section 24. Flowing is evaluating the possibility of a multi-well development program for this acreage.

Flowing also holds a 12.5% interest before payout and 6.25% interest after payout in a producing gas well in the Wildmere area. The 12-30-48-4-W4M well was recently completed for production from the McLaren formation. The well has averaged approximately 500 mcf/d since being placed on production. An uphole Colony zone, which tested at 2.2 mmcf/d on DST, is scheduled for completion at a later date.

Chigwell



Situated 30 km south of Ponoka, Alberta, the Chigwell area contributes just over 50% of Flowing's current production. It includes producing properties and prospects at Ponoka, Nelson and Lacombe. Flowing has an average 86% interest in six producing wells, and a 12% GORR on a fourth well in the area.

During 2001, Flowing participated in the drilling/re-entry of two wells in the area. In March, the 16-21-43-26-W4M well was recompleted for production from the Upper Colony zone and began production at rates of approximately 1 mmcf/d. Flowing retains a net 16.6% interest in the well. Towards the end of the fourth quarter, Flowing twinned its existing 100/6-36-42-26-W4M well targeting prospective shallower zones

including the Edmonton and Belly River. Drilled and cased to a total depth of 778m, the 102/6-36-42-26-W4M well is currently producing gas from the Belly River zone.

Flowing was also successful in farming out its 5 1/4-section exploration block in this area to an industry partner. Subsequent to the acquisition of 20km of seismic data during the second quarter of last year, Velvet spudded a well in July to earn a 100% interest in the lands, subject to a 15% non-convertible overriding royalty held by Flowing. While the well unfortunately resulted in a dry hole, these lands are currently being reviewed for additional locations. The Farmee is evaluating a 3D seismic acquisition program for the third quarter of 2002. Zones of interest in this exploration block include the Basal Quartz, Glauconitic, Colony, Viking and Belly River. Under its farmout agreement, any lands with undrilled spacing units will revert to Flowing after March 1, 2003.

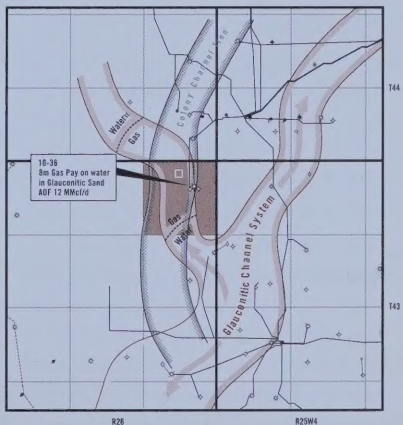
In early 2002, Flowing increased its holdings in the Chigwell area through the acquisition of three producing oil wells and 640 acres of developed land.

EXPLORATION PROSPECTS

Flowing currently has just over 4,000 acres of net undeveloped land. To date, it has identified the following potential prospects on these lands:

Nelson

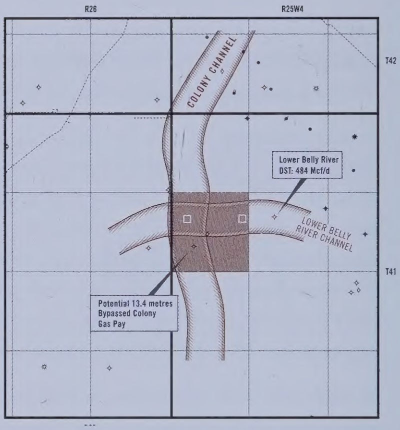
The Nelson prospect is based on an old well that encountered a thick Glauconitic channel sand, which has 8 metres of gas pay over water. This well was tested with an AOF of 12 mmcf/d from this zone, but never produced. In 2000, Flowing drilled a short leg horizontal targeting this zone. Unfortunately, the well encountered low quality shale reservoir that was unable to sustain commercial rates.



In 2001, the Company acquired seismic data over the prospect and has identified a new location which is expected to encounter the Glauconitic channel with good quality reservoir structurally higher than the old original well. This location could have significant reserves depending ultimately on the thickness of the net pay encountered. Furthermore, there is also potential for secondary Colony gas that would be tested by the same well. Tie-in costs would be minimal due to nearby facilities.

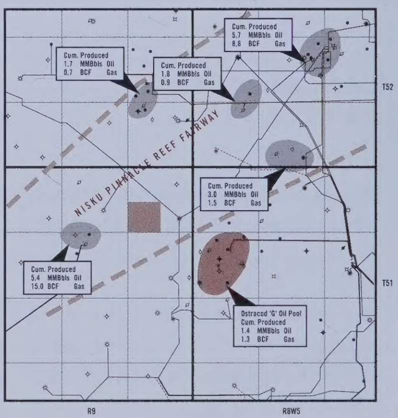
Lacombe

The Lacombe prospect was initially acquired for a Basal Quartz prospect that was drilled in 2000 and proved to have uneconomic reserves. Uphole potential exists in this well for Viking gas. Another location is present on this lease for up to 13 metres of bypassed Colony gas pay by twinning a nearby abandoned well. The Belly River gas is a possible secondary target as another well adjacent to this lease tested gas at economic rates from this zone.



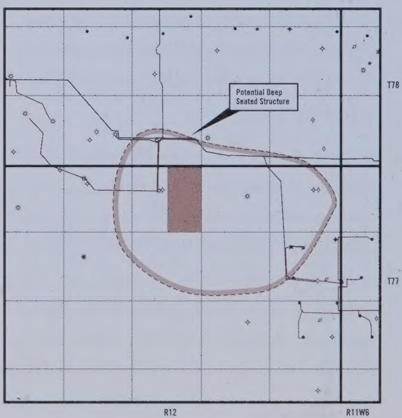
Bigoray

This 100% owned lease is located on the west Pembina pinnacle reef fairway. Reefs in the immediate vicinity of this lease have produced anywhere from 1.7 to 5.7 million barrels of oil each plus associated gas. The closest pinnacle reef is slightly over half a mile away and has produced 5.4 million barrels of oil plus 15 Bcf of gas. This lease also holds potential for Mississippian and Jurassic gas and oil. Additional seismic is required to fully evaluate the drilling potential of this lease.



Pouce Coupe

This 100% owned lease was acquired based on a geologically mapped deep-seated structure exhibiting 4-way dip closure. Target formations include the Mississippian Taylor Flats, Kiskatinaw, and Elkton above 2500 metres and the Devonian Wabamum formation at a depth of approximately 3300 metres. Although the Company's acreage totals 320 acres, the potential pool size could approach 4200 acres with ultimate recoverable reserves estimated at over 100 Bcf of gas. This area has year-round access with good existing pipeline infrastructure tied into a highly underutilized sour gas plant. Flowing currently plans to maximize its acreage position on this prospect and then farm it out to a larger company to test this prospect.



Revenues

Petroleum and natural gas revenues, net of royalties for the year ended December 31, 2001 were $630,924, a decrease of $3,357 or 1% from $634,281 in the prior year. The decrease was attributable primarily to lower oil and gas prices from the prior year and production volume declines from the 100%-owned Ponoka 6-36-42-26 W4M well which was drilled in early 2000 and went on production in the third quarter of 2000.

Expenses

Depletion increased to $315,480 or 66% for the year ended December 31, 2001 compared to $186,666 in the prior year due to an increased asset base from drilling activity in 2000 and increased production relative to proven reserves during the year. Operating expenses increased 21% from $180,831 for the year ended December 31, 2000 to $218,363 for the year ended December 31, 2001 primarily due to a full year of operations of the Ponoka 6-36-42-26 W4M well which was not on production until Q3 of the prior year and the Company's share of operating expenses of the Chigwell 16-21-43-26W4M and Shekelie 2-11-118-8W6M wells that came on production during the year. General and administration expenses were $178,667 for the year ended December 31, 2001 compared to $265,332 for the year ended December 31, 2000. The decrease of $86,665 or 33% from the prior year due in part to the March 2001 departure of a senior executive of the Company who was not replaced until early 2002 and generally lower general and administration costs from much lower activity as the Company farmed-out most of its exploration and development prospects. Interest on debentures and promissory notes increased 127% to $55,000 for the year ended December 31, 2001 from $24,276 in the prior year due to a full year of interest on the convertible promissory note due to shareholder compared to only one quarter's interest being included in the prior year. Future site restoration and abandonment provision for the year ended December 31, 2001 of $17,798 increased 423% from $3,400 in the prior year due to increased production relative to proven reserves during the year and an increase in the net estimated cost of future site restoration and abandonment. There was no ceiling test write down during the year ended December 31, 2001 compared to a write down of $102,000 in the prior year.

The Company had sufficient tax pools and loss carry forwards to reduce income taxes that would otherwise have been payable in the parent company however in the subsidiary company, income taxes of $3,500 were incurred in 2001 due to insufficient tax pools and the full utilization of prior years' tax loss carry forwards .

The net loss for the year ended December 31, 2001 was $76,104 ($0.010 per share) compared to $128,224 ($0.018 per share) for the year ended December 31, 2000.

Liquidity and Capital Resources

In 2001 after the departure of one of its senior executives in Q1 and coming off of disappointing results in 2000 when the Company drilled 3 operated wells, of which one was completed as a gas producer, one was uneconomic and ran over budget and the third was suspended until tie-in costs can be shared, management and the Board of the Company determined that operations required reevaluation with a review of available options to maximize shareholder value. Part of this process

included the repayment, after demand was made for payment, on September 30, 2001 of a $500,000 non-interest bearing demand promissory note by way of the disposition of $500,000 of proven producing properties. It was determined that the best option to proceed with was to bring in new operating management and raise additional capital for growth.

In late December, 2001 the Company raised $405,400 before issue costs through a private placement issue of 2,027,000 flow through shares.

As at December 31, 2001 the Company had a working capital deficiency of $15,355 compared to a working capital deficiency of $545,979 as at December 31, 2000. All sales receivables and trade payables are settled on a monthly basis. The Company has sufficient capital resources and liquidity to meet its obligations as they come due.

Subsequent to December 31, 2001 the Company continued to improve its capital and management resources. In January, 2002 a private placement of 2,877,500 common shares closed for gross proceeds of $575,500. In addition, on February 1, 2002, $300,000 convertible debentures were converted into 1,200,000 common shares. Effective January 2, 2002, a new President and Chief Operating Officer was hired by the Company.

Business Risks

Flowing faces a number of business risks with respect to its oil and gas exploration, development, exploitation and operations activities in Alberta. These risks are not always within the Company's control and can be categorized as operational, financial or regulatory.

The operational risks include finding oil and natural gas reserves on an economic basis, production risk once reserves are discovered and put on production, commodity marketing risk and the risk that sufficient human resources and contract services can be hired and retained in a cost-effective manner. We address these risks by working to procure human resources that are highly qualified, motivated and fairly compensated. Flowing supports long-term relationships with its suppliers to enhance the likelihood that its operations are provided the highest possible quality service consistently. Insurance is in place to protect against pollution, well blowouts and other forms of asset destruction.

Financial risks to Flowing include commodity prices and access to debt and equity markets.

Regulatory risks include environmental concerns such as pollution of air, land and water, which if ignored, can adversely affect Flowing's operations and the environment where our operations are sited. Flowing's policy is to protect and maintain the environment in regards to its operations and to work to comply with government regulations regarding the protection of the environment and the safety of the workplace for our contract service providers.

Business Prospects

Generally, the energy industry is enjoying positive cash flows and earnings. With recent management changes, operational focus and continued access at reasonable cost to debt and equity markets, Flowing is well positioned to take advantage of the future.

To the Shareholders of Flowing Energy Corporation

We have audited the consolidated balance sheets of Flowing Energy Corporation as at December 31, 2001 and 2000 and the consolidated statements of loss and deficit and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with Canadian generally accepted auditing standards. Those standards require that we plan and perform an audit to obtain reasonable assurance whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation.

In our opinion, these consolidated financial statements present fairly, in all material respects, the financial position of the Company as at December 31, 2001 and 2000 and the results of its operations and cash flows for the years then ended in accordance with Canadian generally accepted accounting principles.

Kenway Mack Slusarchuk Stewart LLP

Calgary, Alberta
March 22, 2002

CONSOLIDATED BALANCE SHEETS

December 31		2001		2000
Assets				
Current assets:				
Cash and cash equivalents (Note 2)	$	386,690	$	141,288
Accounts receivable		122,828		484,893
Promissory notes receivable (Note 3)		–		92,500
Promissory note receivable (Note 13)		25,000		–
		534,518		718,681
Investment in Sarnia Minerals Limited (Note 4)		10,000		10,000
Petroleum and natural gas properties (Note 5)				
Cost		2,368,948		2,351,051
Less – accumulated depletion		(635,464)		(319,984)
		1,733,484		2,031,067
	$	2,278,002	$	2,759,748
Liabilities				
Current liabilities:				
Accounts payable and accrued liabilities	$	549,873	$	764,660
Demand promissory note due to shareholder (Note 6)		–		500,000
		549,873		1,264,660
Convertible promissory note due to shareholder (Note 7)		500,000		500,000
Convertible debentures (Notes 8 & 15)		300,000		300,000
Future income taxes (Note 12)		42,000		–
Future site restoration and abandonment costs		21,198		3,400
Commitment (Note 13)				
		1,413,071		2,068,060
Shareholders' Equity				
Share capital (Note 10)		1,465,829		1,216,482
Deficit		(600,898)		(524,794)
		864,931		691,688
	$	2,278,002	$	2,759,748

Approved by the Board:

Director *Director*

CONSOLIDATED STATEMENTS OF LOSS AND DEFICIT

For the Years Ended December 31		2001		2000
Revenue:				
Petroleum and natural gas revenue, net of royalties	**$**	**630,924**	$	634,281
Expenses:				
Depletion		**315,480**		186,666
Operating		**218,363**		180,831
General and administrative		**178,667**		265,332
Interest on debentures and promissory notes		**55,000**		24,276
Future site restoration and abandonment provision		**17,798**		3,400
Write down of petroleum and natural gas properties		–		102,000
		785,308		762,505
Loss before income taxes		**(154,384)**		(128,224)
Income taxes (Note 12)				
Current		**3,500**		–
Future		**(81,780)**		–
		(78,280)		–
Net loss		**(76,104)**		(128,224)
Deficit, beginning of year		**(524,794)**		(396,570)
Deficit, end of year	**$**	**(600,898)**	$	(524,794)
Net loss per share (Note 11)				
Basic and fully diluted	**$**	**0.010**	$	0.018

CONSOLIDATED STATEMENTS OF CASH FLOWS

For the Years Ended December 31	**2001**	2000
Operating activities:		
Net Loss	**$ (76,104)**	$ (128,224)
Items not involving cash:		
Depletion	**315,480**	186,666
Future site restoration and abandonment provision	**17,798**	3,400
Future income taxes	**(81,780)**	–
Write down of petroleum and natural gas properties	–	102,000
	175,394	163,842
Changes in non-cash working capital balances:		
Accounts receivable	**362,065**	(421,192)
Accounts payable and accrued liabilities	**(214,787)**	715,589
Deposits received on convertible debentures	–	(125,000)
	147,278	169,397
	322,672	333,239
Financing activities:		
Issue of share capital, net of share issue costs	**373,128**	536,482
Retirement of promissory notes receivable	**92,500**	–
Issue of promissory note receivable	**(25,000)**	–
Cancellation of shares	**(1)**	–
Issue of convertible promissory note due to shareholder	–	500,000
Issue of demand promissory note due to shareholder	–	500,000
Issue of convertible debentures	–	300,000
	440,627	1,836,482
Investing activities:		
Expenditures on petroleum and natural gas properties	**(517,897)**	(2,378,898)
Proceeds on disposal of petroleum and natural gas properties	–	257,818
Promissory notes receivable	–	(5,000)
	(517,897)	(2,126,080)
Increase in cash and cash equivalents	**245,402**	43,641
Cash and cash equivalents, beginning of year	**141,288**	97,647
Cash and cash equivalents, end of year	**$ 386,690**	$ 141,288

1 Significant Accounting Policies

Basis of presentation

The Corporation incorporated under the Business Corporations Act (Alberta) and is currently involved in the exploration, exploitation, development and production of petroleum and natural gas reserves in the Province of Alberta.

The financial statements at December 31, 2001 and for the year then ended are presented on a consolidated basis and include the accounts of Flowing Energy Corporation (the "Corporation") and its wholly owned subsidiary, Flowing Energy Inc.

These consolidated financial statements have been prepared in accordance with Canadian generally accepted accounting principles which require management to make estimates and assumptions that affect the reported amounts of assets and liabilities and disclosure of contingencies at the date of the financial statements and the reported amounts of revenues and expenses during the reported period.

Certain of the prior year's figures have been reclassified to conform to the current year's presentation.

Measurement uncertainty

The amounts recorded for depletion and depreciation of oil and gas properties and the provision for future site restoration costs are based on estimates. The ceiling test calculation is based on estimates of proven reserves, production rates, petroleum and natural gas prices, future costs and other relevant assumptions. By their nature, these estimates are subject to measurement uncertainty and the effect on the financial statements of changes in such estimates in future periods could be significant.

Cash and cash equivalents

Cash and cash equivalents are those short-term money market instruments which, on acquisition, have an original term to maturity of three months or less.

Credit risk management

The Corporation's accounts receivable are with customers in the oil and gas industry and are subject to normal industry credit risk.

Investments

Investments in shares of other companies are carried at cost or at cost less amounts written off to reflect an impairment in value that is other than a temporary decline.

Petroleum and natural gas properties

The Corporation follows the full-cost method of accounting whereby all costs related to the acquisition, exploration and development of petroleum and natural gas properties are capitalized. Capitalized costs are limited by a "ceiling value", being the estimated future net revenues, after tax, from production of proven reserves, at prices and costs in effect at year-end plus the lower of cost and estimated value of unproved properties. Gains or losses are not recognized upon the disposition of properties unless a significant change in the depletion rate would result.

The costs of petroleum and natural gas properties are depleted using the unit-of-production method where the ratio of current year production to proven reserves, before royalties, determines the proportion of depletable costs to be expensed. Gas reserves and production are converted to barrels of crude oil on a heat equivalent basis. The cost of unproved acreage is excluded from the depletion calculation.

Joint venture operations

Where the Corporation's exploration and production activities are conducted jointly with others, the accounts reflect only the Corporation's proportionate interest in such joint activities.

Provision for future site restoration

Estimated future site restoration and abandonment costs are provided for over the life of the proven reserves on a unit-of-production basis. Costs are estimated each period by management based on current regulations, costs, technology and industry standards. The amount has been recorded as future site restoration and abandonment provision.

Flow through shares

Resource expenditure deductions funded by flow through share arrangements are renounced to investors in accordance with income tax legislation. The carrying value of the shares issued are reduced by the tax effect of the tax deductions when the benefits are renounced.

Income taxes

The Corporation follows the liability method of accounting for income taxes. Under this method, income tax assets and liabilities are recognized based on the estimated tax effects of temporary differences in the carrying value of assets and liabilities in the financial statements and their respective tax bases, using income tax rates enacted on the balance sheet date. The effect of a change in income tax rates on the future income tax assets and liabilities is recognized in income in the period of the change.

2 Cash and Cash Equivalents

Cash and cash equivalents are comprised of bank deposits of $386,690 (2000 – overdraft of $102,612) and term deposits of Nil (2000 – $243,900).

3 Promissory Notes Receivable

On September 30, 2001 the promissory notes receivable, including accrued interest receivable, matured. The notes were issued upon the issue of share capital, had no fixed terms of repayment, and bore interest at 4%, with an original maturity date of June 30, 2001. The maturity date was extended to September 30, 2001, and the notes were secured by shares of the Corporation.

4 Investment in Sarnia Minerals Limited

The Corporation owns approximately 20% of the outstanding shares of Sarnia Minerals Limited, a company in the mineral exploration industry in the Republic of Georgia.

5 Petroleum and Natural Gas Properties

No overhead charges have been capitalized to Petroleum and Natural Gas Properties.

The cost of undeveloped property excluded from the depletion base as at December 31, 2001 was $309,858 (2000 – $680,765).

For the year ended December 31, 2001, the Corporation incurred a ceiling test write-down of $Nil (2000 – $102,000).

The Corporation used the average price calculated from the 12 month period of January to December 2001, of $5.54 per mcf of gas to perform the ceiling test calculation. As a result of this test, no write-down was incurred. Had the Corporation's December closing price for gas of $3.52 per mcf been used, an amount of approximately $1.1 million would have been required as a ceiling test write-down.

6 Demand Promissory Note Due to Shareholder

In exchange for a demand promissory note, in 2000 the Corporation borrowed $500,000 from a corporation that is a shareholder and has an officer and directors that are also an officer and directors of the Corporation. The note was payable on demand and in lieu of interest, the Corporation granted the shareholder or the shareholder's nominee a two year option, from August 23, 2000, to purchase $500,000 of proven producing reserves of the Corporation in accordance with the rules of the Canadian Venture Exchange (CDNX) and satisfactory to the CDNX. In September 2001, after demand for payment was made by the demand promissory note holder, it exercised its option to be repaid by purchasing from the Corporation a $500,000 proven producing property with a NPV 15% using constant dollar pricing. The repayment of the $500,000 demand promissory note and sale of the proven producing property were made effective with the close of business September 30, 2001.

7 Convertible Promissory Note Due to Shareholder

In 2000 the Corporation issued a $500,000, 8% Subordinated Convertible Promissory Note to a shareholder for cash. The shareholder has an officer and directors that are also an officer and directors of the Corporation. The note is due September 30, 2005 but may be repaid at any time, bears interest at 8% per annum and is fully subordinated to all senior debt. During the year, $40,000 (2000 - $10,000) of interest was paid on the note. The holder of the note may convert the principal of the note into common equity of the Corporation at a 10% discount to market, in accordance with applicable securities regulations. Additionally, the shareholder or its nominee holds a two year option from August 23, 2000 to participate, prior to spud date, for a maximum of $1.67 million, in the farm-in of petroleum and natural gas plays of the Corporation's in the Province of Alberta on a 100 for 50 basis using standard CAPL terms.

8 Convertible Debentures

In 2000 the Corporation issued $300,000 convertible debentures bearing 5% interest payable annually and due on February 1, 2003. The convertible debentures are convertible into 1,200,000 common shares at $0.25 per share on or before January 31, 2002 or 1,000,000 common shares at $0.30 per share between February 1, 2002 and February 1, 2003. Of these convertible debentures, $280,000 were issued to directors, officers or consultants of the Corporation.

9 Commitment and Settlement of Statement of Claim

Letter of credit

In 2000 and on behalf of the Corporation, a shareholder provided a letter of credit (the "Letter of Credit") in the amount of $100,000 to the Alberta Court to cover potential legal costs in a lawsuit explained below. In the event the Letter of Credit would have been required to be honoured, the Corporation would have been required to pay on demand to the shareholder, the value of the Letter of Credit. In March 2001, the Letter of Credit was discharged in full by the Alberta Court in accordance with the settlement of the lawsuit as discussed below.

Settlement of statement of claim

On February 14, 2001, the Corporation settled a statement of claim it filed against the vendor, the operator and the independent engineers of the Corporation's subsidiary's Sousa-Fire acquisition. Under the terms of the settlement agreement effective December 1, 2000 the Corporation parted with its interest in the Sousa-Fire oil and gas properties and received a cash settlement of $225,000 and additional interests in the Snowfall properties. This portion of the settlement was recorded in the financial statements as at and for the year ended December 31, 2000.

Also, as part of the settlement, effective February 14, 2001, certain shareholders returned 877,700 common shares to the Corporation for cancellation. The shares were originally recorded at an aggregate value of $1.

10 Share Capital

Authorized

Unlimited number of common voting shares.

Unlimited number of preferred shares issuable in one or more series.

Issued

	2001		2000	
	Number of Common Shares	**Amount**	Number of Common Shares	Amount
Balance, beginning of year	**8,357,386**	**$ 1,216,482**	5,800,000	$ 680,000
Issued to officer and director under employment agreement			600,000	102,000
Cancellation of shares	**(877,700)**	**(1)**	–	–
Issued on exercise of options	–	–	243,750	48,750
Issued pursuant to private placement	–	–	113,636	50,000
Issued pursuant to private placement of flow through shares	**2,027,000**	**405,400**	1,600,000	800,000
Tax effect of flow through shares	–	**(123,780)**	–	(356,960)
Issue costs	–	**(32,272)**	–	(107,308)
Balance, end of year	**9,506,686**	**$ 1,465,829**	8,357,386	$ 1,216,482

Common shares reserved for issuance

The Corporation has a stock option plan for its directors, officers and consultants which provides options to purchase Common Shares at various prices. Under the current plan, the maximum term of options is five years. Options vest and are exercisable on a cumulative basis as to one third on each of the first, second and third anniversary of the grant date. The Corporation does not record any amounts to compensation expense related to the granting or exercise of options. The amount received by the Corporation for the Common Shares issued is credited to Share Capital when exercised.

At December 31, 2001, the Corporation has the following options outstanding:

Issued to directors, officers, and consultants:

Shares	Price	Expiry Date
200,000	$ 0.25	February 1, 2005
50,000	$ 0.40	May 22, 2005
250,000	$ 0.52	August 31, 2005
10,000	$ 0.15	September 5, 2006
510,000		

In addition, the Corporation issued the following options to the agents in connection with brokered private placements completed in 2000 and 2001:

Shares	Price	Expiry Date
114,000	$ 0.50	August 11, 2002
46,000	$ 0.50	September 1, 2002
36,500	$ 0.20	December 31, 2006
196,500		

Summary of stock options

Options issued pursuant to stock option plan:

	2001		2000	
	Shares	**Weighted-Average Exercise Price**	Shares	Weighted-Average Exercise Price
Options outstanding at beginning of year	**710,000**	**$ 0.40**	243,750	$ 0.20
Granted	**10,000**	**$ 0.15**	710,000	$ 0.40
Exercised			(243,750)	$ 0.20
Forfeited (cancelled)	**(210,000)**	**$ 0.39**		
Options outstanding at end of year	**510,000**	**$ 0.40**	710,000	$ 0.40
Options exercisable at end of year	**267,500**		100,000	

Options issued pursuant to brokered private placements:

	2001		2000	
	Shares	**Weighted-Average Exercise Price**	Shares	Weighted-Average Exercise Price
Options outstanding at beginning of year	**160,000**	**$ 0.50**	–	
Granted	**36,500**	**$ 0.20**	160,000	$ 0.50
Options outstanding at end of year	**196,500**	**$ 0.44**	160,000	$ 0.50
Options exercisable at end of year	**196,500**		160,000	

11 Net Loss Per Share

Net loss per share has been calculated using the weighted average number of shares outstanding during the year of 7,596,598 (2000 – 7,052,922). The net loss per share is $0.010 (2000 – $0.018).

12 Income Taxes

Income tax expense differs from what would be expected from applying the effective income tax rate of 41.62% (2000 – 44.62%) to income before income taxes. The difference results from the following:

		2001		2000
Expected income tax provision	$	**(64,254)**	$	(57,214)
Increase (decrease) income tax provision:				
Non-deductible crown royalties, net of Alberta Royalty Tax Credit		**21,162**		48,534
Non-deductible portion of depletion		–		43,375
Resource allowance		**(24,933)**		(29,122)
Share issue costs		**(13,432)**		–
Previously unrecorded tax basis		**5,712**		–
Other		**(2,535)**		(5,573)
Actual income tax provision	$	**(78,280)**	$	–

Future income taxes consist of the following temporary differences:

Net book value of petroleum and natural gas properties in excess of tax value	$	183,600
Tax cost of investment in Sarnia Minerals Limited in excess of carrying value		(46,400)
Non-capital losses		(48,900)
Share issue costs		(37,500)
Future site restoration and abandonment costs		(8,800)
	$	42,000

The Corporation has non-capital losses of $117,606 which may be utilized to reduce taxable income in future years. These losses expire as follows:

2005	$	38,352
2006		31,537
2008		47,717
	$	117,606

13 Related Party Transactions and Commitment

In 2000 the subsidiary of the Corporation purchased from a corporation controlled by a director and officer, petroleum and natural gas properties valued at $95,000 in exchange for a non-interest bearing promissory note. The transaction was measured at the exchange amount. As at December 31, 2001, the balance owing on the promissory note of $53,560 (2000 – $86,800) is included in accounts payable and accrued liabilities.

Under the terms of an administrative services contract (the Administrative Services Contract) dated October 1, 2000, between the Corporation and a corporation controlled by certain directors and officers of the Corporation, the Corporation incurred management fees of $142,000 (2000 – $49,755) for the provision of offices, office equipment, corporate officers, management and support personnel. The term of the Administrative Services Contract was

for one year, renewable for additional one year terms at the option of the Corporation. The Administrative Services Contract was extended to the year ended December 31, 2001 and renewed January 1, 2002 for an additional one year term for a total of $126,000 payable in equal monthly instalments. The transactions were measured at the exchange amount and were in the normal course of operations. As at December 31, 2001, the amount owed under the Administrative Services Contract and included in accounts payable and accrued liabilities is $11,500 (2000 – $49,755).

Prior to the execution of the Administrative Services Contract in 2000, the Corporation had no employees and utilized certain personnel of a shareholder to manage and operate the Corporation. The shareholder has an officer and certain directors that are an officer and directors of the Corporation. For the year ended December 31, 2001 general and administration expenses include a charge of $Nil (2000 – $98,000) and as at December 31, 2001 accounts payable and accrued liabilities include an amount of $89,639 (2000 - $98,000) to reimburse the shareholder for general and administrative expenses incurred to operate the Corporation. The transactions were measured at the exchange amount and were in the normal course of operations.

In exchange for a Promissory Note Receivable, in December 2001 the Corporation loaned $25,000 to a person who became a director and officer of the Corporation in January 2002. The Promissory Note Receivable is non-interest bearing, and is due on or before April 1, 2002.

14 Fair Value Disclosure

The fair value of all the Corporation's financial assets and liabilities approximates their carrying value.

15 Subsequent Events

On January 1, 2002, the Company granted 200,000 incentive stock options to an officer of the Company with an exercise price of $0.20 per share. The options expire on January 1, 2007.

During January 2002, a private placement of 2,877,500 common shares closed for gross proceeds of $575,500.

On February 1, 2002, $300,000 convertible debentures were converted into 1,200,000 common shares at $0.25 per share.

On March 12, 2002, the Corporation entered into an agreement to purchase producing oil and gas properties in central Alberta for $60,000. The effective date of the transaction was as of March 1, 2002 with the closing on April 1, 2002.

16 Supplemented Cash Flow Information

The Company has made cash payments of interest of $55,000 (2000 – $14,276) during the year.

CORPORATE INFORMATION

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David G. Mallory, Chief Financial Officer

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